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DEPT FOR EUR/CARC
PLEASE PASS TO OPIC SENIOR INVESTMENT OFFICER JAMES GALE

E.O. 12958: N/A
TAGS: EINV ECON AM
SUBJECT: A DECENT BET: PROPOSED OPIC FINANCING FOR FIRST MORTGAGE

REF: STATE 36310

Sensitive but unclassified. Please protect accordingly.

SUMMARY:

¶1. (SBU) The following information, provided per reftel, concerns OPIC's proposal to provide a USD 5 million loan to First Mortgage Company (FMC). Post believes that FMC is a strong prospective partner and that there is significant potential within the Armenian mortgage market. Any loan agreement, however, should reflect that perfectibility of mortgage loans in Armenia is largely untested and that successful foreclosure in the event of default would be extremely difficult at best. Additionally, recent amendments to the Armenian currency law are ambiguous in their application to the mortgage market. Due to FMC CEO David Atanessian's recent political activities, OPIC should consider delaying awarding the loan until after Armenia's May 12, 2007 parliamentary election. Post's ability to vet company representatives named in reftel was limited by the lack of biographical data, but we are not immediately aware of any negative information. END SUMMARY.

A DYNAMIC MORTGAGE MARKET

¶12. (SBU) Armenia's mortgage market is growing rapidly and is currently estimated to include USD 75 million in outstanding loans. The mortgage market has effectively doubled since 2006, but long-term funding remains scarce and is largely provided by the German assistance group KfW through an Euro 18 million assistance package. There are 15 banks and credit organizations offering mortgages in Armenia, but only FMC and Washington Capital specialize in mortgages.

CONSTRUCTION BOOM (AND MAYBE BUBBLE)

¶13. (SBU) Much of the mortgage market is connected to Armenia's booming construction sector. Construction has been the leading driver of Armenia's impressive double-digit GDP growth for the past five years. The residential construction industry includes both new construction and refurbishment of existing homes and buildings. Much of the new construction is beyond the price range of the local population. Premium-priced housing is marketed especially to affluent ethnic-Armenians living permanently abroad, who may spend several months per year in Armenia, though this market is

finite and risks being over-supplied. Some observers, including members of the Armenian Central Bank and the local representative of EBRD, have voiced concerns about a possible housing bubble, particularly within the capital, Yerevan. The less conspicuous, but probably much more stable long-term business prospects are for mortgages aimed at Armenia's steadily growing middle-class, which remains seriously undeserved by the existing housing stock and by financial instruments that could help put moderate-priced new homes (or major existing-home renovations) within reach. Local demand for housing remains strong.

PERFECTIBILITY UNCERTAIN

¶4. (SBU) Thanks in part to assistance from USAID, the state land cadastre (deed registry) is recognized as a reasonably solid institution and legal land title is well established. The Armenian judiciary remains underdeveloped however, and, because the mortgage industry is relatively new to Armenia, the legal perfectibility of mortgage loans is essentially untested. In other words, it remains to be seen whether the Armenian legal system and legislative framework is truly ready to enforce mortgage agreements. There is no clear precedent for foreclosure cases and foreclosure in the event of default would be extremely difficult at best, and might well prove to be impossible.

SIGNIFICANT FOREX RISKS

¶5. (SBU) Recent amendments to the Currency Control Law have posed a challenge to the mortgage market. The law requires that all consumer loans be issued in the local currency (drams) but is ambiguous on whether mortgage loans are considered "consumer loans." Many mortgage companies, including FMC, complained about this ambiguity in the law saying that mortgage companies which source their funds in dollars and are required to make loans in drams are forced to assume an unreasonable currency risk. The 18.9 percent appreciation of the dram in 2006 underscores the potential gravity of their concern. The Central Bank of Armenia (CBA) issued a clarification stating that mortgage loans are not consumer loans for the purposes of this law, but CBA clarifications are not binding on other government bodies, can be changed at any time and are not legally enforceable. FMC and the American Chamber of Commerce in Armenia have called for amendments to the currency law to resolve this ambiguity, but there is no evidence that such amendments are under consideration. As a matter of prudence, we expect that FMC will likely issue loans in drams and will have to adjust their lending rates to account for the foreign exchange risk.

A POLITICAL QUESTION MARK

¶6. (SBU) FMC was established in 2004 as a "universal credit organization" under the banking laws of Armenia. Unlike banks, universal credit organizations, are not required to make public company financial information. FMC, however, enjoys a strong business reputation, is already in partnership with the German Development Bank KfW, and is under consideration for a future partnership with USAID. CEO David Atanessian is widely respected within the business community and is an active member of the American Chamber of Commerce in Armenia, and Chairman of the British Alumni Association (an association of students who studied in the UK thanks to assistance from the British Embassy). Recently, Atanessian helped found the United Liberal National (or "MIAK" by Armenian acronym) political party. This small group of western-oriented Armenians (mostly alumni of British or American universities) has yet to have a significant impact on the Armenian political arena. Atanessian's vocal support for an anti-corruption agenda, however, may cause him

problems in the run up to the May 12, 2007 parliamentary elections.

POSSIBLE USAID-FMC PARTNERSHIP

17. (SBU) USAID is considering a development credit authority grant to FMC whereby USAID would guarantee FMC bonds issued on both the local and international markets. Under this agreement, which is still in the due diligence phase, FMC would be able to raise capital to support non-traditional mortgage lending, including smaller loans (approximately USD 5,000) to rural Armenians seeking to renovate existing properties. Due to the ambiguity in the currency law, USAID is planning to contractually require the FMC make its loans in drams.

COMMENT: A DECENT BET

18. (SBU) Given the strength of the Armenian mortgage market and FMC's business reputation, the proposed loan appears reasonable. OPIC should be careful to clarify in which currency FMC plans to offer its loans and to ensure that the rate of return is sufficient to cover the foreign exchange risk. OPIC should also be aware that there is virtually no precedent for successful foreclosure and, in the event of default, foreclosure might well prove to be impossible. We urge OPIC to delay approval of the loan until after Armenia's May 12 parliamentary elections to avoid any appearance of political motivation.

GODFREY